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SUBJECT: EBRD PREVIEWS TURKMENISTAN TRANSITION REPORT;  
DISCUSSES INFLATION FIGURES

REF: ASHGABAT 1352

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: The head of the European Bank for Reconstruction and Development's (EBRD) Ashgabat office gave a preview of the Bank's annual Transition Report on Turkmenistan and discussed the consumer price index and inflation figures with representatives of EBRD's shareholders. EBRD developed its inflation figures -- valuable data in Turkmenistan since the government does not release any reliable economic data -- through market checks and in-house analysis. According to the EBRD, the Transition Report is a unique source of information on developments in the EBRD region, including country-by-country macroeconomic tables and key data on liberalization and privatization, enterprise reform, infrastructure, financial institutions and social reform. END SUMMARY.

INFLATION FIGURES FOR 2008

13. (SBU) On October 9, the Head of the EBRD's Resident Office in Turkmenistan, Neil McKain, held the first quarterly lunch meeting for shareholders to discuss economic issues of interest in Turkmenistan. Representatives from the French, Georgian, German, Japanese, Turkish, UK and U.S. Embassies attended the lunch. The theme of the first meeting was EBRD's Turkmenistan Consumer Price Index and EBRD's draft Turkmenistan "Transition Report." Inflation figures are as follows:

-- Inflation rate over the last 12 months (October 2007-September 2008): 19.4 percent  
-- Foodstuffs: 6 percent (60 percent weighting)  
-- Non-food grocery: 11 percent (15 percent weighting)  
-- Transportation and energy: 129 percent (10 percent weighting)  
-- Services: 44 percent (15 percent weighting)

INFLATION FORECASTS: REDENOMINATION WILL CAUSE A SPIKE

¶4. (SBU) McKain said the EBRD inflation figure represents a one percent increase over the previous year. EBRD forecasts that by the end of December, Turkmenistan will have had 16 percent inflation for the calendar year 2008. McKain also noted that the Government of Turkmenistan revised its inflation target for 2008 from 9 to 12 percent. McKain added that, per historical experience in other countries around the world that have revalued currency, inflation is expected to increase with the redenomination of the Turkmen manat that is expected to occur on January 1, 2009. EBRD also projects that inflation may again spike at 17 percent at the end of ¶2009. McKain noted that all inflation figures mask actual inflation due to the prevalence of subsidies available to Turkmenistan's consumers. However, he suggested that Turkmenistan may be less inclined to continue gasoline subsidies as the country begins to charge world market prices for gas and oil exports, thereby earning more than in the past.

#### EBRD'S DRAFT TRANSITION REPORT FOR TURKMENISTAN

¶5. (SBU) According to EBRD's draft Transition Report, the key developments and challenges for Turkmenistan are:

- The business environment needs to improve further if private sector activity is to increase.
- Heavy investment is needed in education and health care to stimulate the development of human capital.
- Exchange rate unification was an important development and should encourage/enable foreign direct investment.

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¶6. (SBU) Turkmenistan has made progress in its structural reform:

- Privatization is not high on the Government of Turkmenistan's agenda.
- Focus is on small and medium enterprise development.
- Establishment of the Supreme Audit Chamber is a positive move forward.
- New Constitution offers protection for entrepreneurs.

¶7. (SBU) The business environment and competition issues are still difficult but some improvements offer some cause for optimism:

- New legislation allowing property and land ownership and the repatriation of profits, changes which ease market entry for foreign investors.
- Break up of the state's monopolies over Internet provision and mobile telephones.
- Exchange rate unification that occurred in May 2008, and opening up of exchange offices and abolition of limits on foreign exchange transactions.

¶8. (SBU) Several items were noted regarding Turkmenistan's financial sector:

- The sector is small and state controlled, with only one majority privately owned bank (Senagat Bank).
- Before exchange rate unification, the distorted foreign exchange market and direct monetary controls led to a low level of monetization and constrained the role of banks in the economy.
- New foreign exchange regulations in June 2008 allow the Central Bank to provide banks with ready access to foreign exchange.
- The new regulations also allow commercial banks to open correspondent accounts.
- A large portion of commercial bank lending is still directed to state-owned enterprises at below market interest rates.

¶9. (SBU) Although EBRD's focus is not on social factors, the organization does follow relevant developments, especially in

Turkmenistan where education and health are areas that need significant assistance.

-- Turkmenistan adopted a new social welfare code in July 2007.  
-- Inflationary pressures have all but wiped out wage and pension increases.  
-- The Rural Development Plan is "patchy" but does address the serious lag in health and education.  
-- The reinstatement of the eight-year basic education system and the target of attaining "Commonwealth of Independent States standards" in education.

¶10. (SBU) EBRD noted the following about macroeconomic performance:

-- Turkmenistan experienced strong gross domestic product growth of 7.5 percent in the first half of 2008.  
-- Despite an increase in imports, the current account surplus remains strong at 15.4 percent.  
-- The 2007 budget surplus is 4 percent.  
-- Off-budget activity remains significant.

¶11. (SBU) EBRD made predictions on economic outlook and risks:

-- Strong hydrocarbon-driven growth will continue.  
-- Internal and external inflationary pressures will also continue to have an impact.  
-- Increasing the activities of the private sector -- outside

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of oil and gas -- would be a key factor in improving Turkmenistan's economy.

¶12. (SBU) COMMENT: EBRD's inflation figures are important data as the Government of Turkmenistan does not publish any reliable figures. EBRD will release the final version of the Transition Report in November, and requested that recipients not distribute this information until the document's release.

The group at this meeting proceeded to discuss economic trends and how the international community could encourage improvement of the business environment (reftel). END

COMMENT.

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